No. 7855

In the United States Circuit Court of Appeals for the Ninth Circuit

O. O. EATON, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE RESPONDENT

JAMES W. MORRIS,
Assistant Attorney General.
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Special Assistants to the Attorney General.

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PREVIOUS OPINIONS

The first findings of fact and memorandum opinion of the United States Board of Tax Appeals (R. 17–22)[1] are not reported. The previous opin-

[1] It was ordered by this Court on April 24, 1937, that the transcript of the record in the former petition for review before this Court in this case may be considered as a part of the transcript of the record in the instant petition for review. Therefore throughout this brief references to that transcript are designated "R", followed by the page reference in that transcript, and references to the instant transcript of record will be made by "S. R.", followed by the page reference.

ion of this Court is reported in 81 F. (2d) 332. The memorandum opinion of the Board of Tax Appeals entered upon the rehearing on the remand of this Court (S. R. 7–11) is not reported.

JURISDICTION

This petition for review involves income taxes for the year 1928 in the sum of $4,537.06, and is taken from the decision of the Board of Tax Appeals entered June 15, 1936. (S. R. 11–12.) The motion to vacate the decision of the Board (S. R. 12–20) was denied January 9, 1937 (S. R. 20–21). The petition for review was filed April 8, 1937 (S. R. 22–32), pursuant to the provisions of Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, and by Section 519 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

QUESTION PRESENTED

Whether the taxpayer may make a deduction for a loss alleged to have been sustained in 1928 because of the removal and destruction of a large number of fruit trees shortly after taxpayer's purchase of the orchards in which the trees were located.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved are set forth in the Appendix, *infra,* pp. 9–10.

STATEMENT

The facts as found by the Board of Tax Appeals (R. 17–19; S. R. 7–11) are as follows:

The taxpayer is an individual residing at Watsonville, California, where he has been engaged in the business of farming and fruit raising for more than thirty-five years. In that time he has been a large producer of strawberries, apples, and lettuce. Prior to 1928, the taxable year, he owned and operated about one hundred acres of apple orchards and seventy-five acres of apricots.

In the fall of 1928, taxpayer purchased three farms of 10½, 29.89, and 74 acres at the respective cost of $8,300, $30,000, and $42,500. These farms are located near Watsonville, in close proximity to a railroad and lie alongside the only paved state highway in that vicinity. Nearly all the land so acquired was black soil and planted mostly in apple trees, but there were a few pear trees and a small area on the larger place which is not well adapted to orcharding. The purchase was made after the apple crop of 1928 had been gathered.

At the date of the purchase of the above farms, the apple trees thereon were about thirty-five years old. In that locality an apple orchard comes into profitable bearing about ten years after planting, reaches its most productive period at about the thirtieth year,[2] and ceases to be profitably produc-

[2] The record (p. 18) states "thirteenth", but it will be seen from reading the testimony (R. 53) that this is an error.

tive between forty and fifty years after planting. In 1928, the average price of bare orchard land in the neighborhood of Watsonville was about $500 per acre. The cost of an orchard from planting to profitable production is about $400 per acre, which includes interest on the cost of land.

Immediately after the purchase in 1928, the taxpayer, late in 1928 and early in 1929, pulled up and removed 3,428 apple trees and 360 pear trees at a cost of $950.15 for labor.

Beginning some time before the taxable year, there was a tendency in the Watsonville district to reduce apple production and engage in the growing of lettuce and other annual crops. Taxpayer planted the ground cleared of trees, as above described, in lettuce, and since 1929 has been the largest grower thereof in that neighborhood.

In his income tax return for the year 1928, the taxpayer deducted $18,940 from his gross income as a loss representing the remaining useful value of the 3,788 trees destroyed in that year, and included in "other deductions" the amount of $950.15 as the labor cost of removing the apple trees. Upon audit, the Commissioner held that such deductions represented investments of capital, and increased the taxpayer's reported income accordingly (R. 10–11).

From the deficiency thus determined, the taxpayer appealed to the Board of Tax Appeals, alleging that upon the purchase of the land he con-

templated the use thereof as an orchard. The Board of Tax Appeals in its original opinion held that the evidence was insufficient to sustain the taxpayer's claim for deduction and to overcome the presumptively correct determination of the Commissioner (R. 22), and entered its decision determining the deficiency in question (R. 22).

This Court by order entered February 17, 1936 (S. R. 4–5), remanded this cause to the Board of Tax Appeals with directions that the Board make two specific findings: (1) "* * * a specific finding on the question of whether or not the loss incurred by the taxpayer was incurred in the course of his trade or business, * * *" and (2) "* * * a specific finding * * * on the question of whether or not the taxpayer at the time he purchased the land intended to destroy the trees."

This proceeding was restored to the day calendar of the Board of Tax Appeals for hearing in conformity with the order and opinion of this Court (S. R. 6). Thereafter, on April 22, 1936, the taxpayer and the respondent appeared before the Board of Tax Appeals and a hearing was had in these proceedings (S. R. 2). On May 18, 1936, in the memorandum opinion of the Board of Tax Appeals on the order of this Court remanding the case to the Board (S. R. 7–11), the Board specifically found as "a fact that any loss that may have been sustained by the petitioner [taxpayer]

by reason of the destruction of the apple and pear trees on the land purchased was incurred in the course of the petitioner's [taxpayer's] trade or business" (S. R. 8). The Board further found as "a fact that the petitioner [taxpayer] at the time he purchased the land in question intended to destroy the trees that were destroyed immediately thereafter and to retain those trees that were saved" (S. R. 9).

The Board thereupon having found as a fact that the taxpayer did intend to destroy the trees in question at the time he purchased the land, held that he sustained no deductible loss by reason of the destruction of the trees, and determined a deficiency in income tax of $4,537.06 for the year 1928 (S. R. 11–12).

SUMMARY OF ARGUMENT

The findings of the Board of Tax Appeals, pursuant to the remand by this Court of these proceedings to the Board for such findings, are in entire conformity with the order of this Court remanding the case to the Board and are supported by substantial evidence. Therefore, the decision of the Board, based on such findings, should not be disturbed.

ARGUMENT

In the interests of brevity and to avoid needless repetition, the respondent adopts and incorporates herein by reference the argument presented in the brief for the respondent filed in this Court in this

petition for review, No. 7855, brought originally before this Court for consideration. In addition to the arguments made therein, the respondent submits that the findings made by the Board of Tax Appeals on the order of remand entered by this Court are the findings, expressly and specifically, which this Court by its order directed the Board to make. These findings should not be disturbed on review if there is any substantial evidence in the record to support such findings. *Phillips* v. *Commissioner,* 283 U. S. 589, 592; *Helvering* v. *Rankin,* 295 U. S. 123, 131.

It is unnecessary to point out the substantial evidence which supports the Board's finding of fact that it was the intention of the taxpayer at the time of the purchase of the property to destroy the trees in question. This Court in its original opinion in this case (81 F. (2d) 332) pointed out (pp. 333, 334) the evidence in the record that supports such finding, and stated that it could not disregard the finding as one not supported on the evidence. See also brief for the respondent originally filed with this Court in this proceeding (pp. 13–15).

The Board of Tax Appeals found what this Court has said to be the ultimate fact in this case (*Eaton* v. *Commissioner, supra,* pp. 333, 334) that *any loss which the taxpayer may have sustained* by reason of the destruction of the trees on the land purchased was incurred in the course of the taxpayer's trade or business (S. R. 8), i. e., the busi-

ness of growing fruits and vegetables, principally lettuce. However, as the Board of Tax Appeals said (Memorandum Opinion, S. R. 10–11), if the taxpayer at the time he purchased the land in question intended to destroy the trees and use the land for other purposes, no part of the cost of the property was allocable to the destroyed trees, and the trees destroyed having no cost basis it cannot be said that any deductible loss resulted from their destruction.

Under the findings of the Board of Tax Appeals, which have ample support in the evidence, it seems clear that the taxpayer under the facts of the instant case sustained no loss, deductible or otherwise, from the destruction of the trees in question.

CONCLUSION

The decision of the Board of Tax Appeals is correct and should be affirmed.

Respectfully submitted.

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OCTOBER 1937.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (e) *Losses by individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—
>
> (1) if incurred in trade or business; or
>
> (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or
>
> (3) of property not connected with the trade or business, if the losses arises from fires, storms, shipwreck, or other casualty, or from theft.

Treasury Regulations 74:

> ART. 172. *Voluntary removal of buildings.*—Loss due to the voluntary removal or demolition of old buildings, the scrapping of old machinery, equipment, etc., incident to renewals and replacements will be deductible from gross income. When a taxpayer buys real estate upon which is located a building, which he proceeds to raze with a view to erecting thereon another building, it will be considered that the taxpayer has sustained no deductible loss by reason of the demolition of the old building, and no deductible expense on account of the cost of such removal, the value of the real estate, exclusive of old improvements, being pre-

sumably equal to the purchase price of the land and building plus the cost of removing the useless building.

ART. 173. *Loss of useful value.*—When, through some changes in business conditions, the usefulness in the business of some or all of the capital assets is suddenly terminated, so that the taxpayer discontinues the business or discards such assets permanently from use in such business, he may claim as a loss for the year in which he takes such action the difference between the basis (adjusted as provided in section 111 and article 561) and the salvage value of the property. This exception to the rule requiring a sale or other disposition of property in order to establish a loss requires proof of some unforeseen cause by reason of which the property has been prematurely discarded, as, for example, where an increase in the cost or change in the manufacture of any product makes it necessary to abandon such manufacture, to which special machinery is exclusively devoted, or where new legislation directly or indirectly makes the continued profitable use of the property impossible. This exception does not extend to a case where the useful life of property terminates solely as a result of those gradual processes for which depreciation allowances are authorized. It does not apply to inventories or to other than capital assets. The exception applies to buildings only when they are permanently abandoned or permanently devoted to a radically different use, and to machinery only when its use as such is permanently abandoned. Any loss to be deductible under this exception must be fully explained in the return of income.

U. S GOVERNMENT PRINTING OFFICE: 1937